


Memorandum

To: Honorable Betty T. Yee, Chairwoman
Honorable Jerome E. Horton, Vice Chair
Senator George Runner, Second District
Honorable Michelle Steel, Third District
Honorable John Chiang, State Controller

Date: January 14, 2011

From: Randy Ferris 
Acting Chief Counsel

Subject: **Petition for Amendment of Property Tax Rule 462.160**
Change in Ownership – Trusts
January 27, 2011 Board Meeting – Chief Counsel Matters – Item J – Rulemaking

On January 3, 2011, the Legal Department received Mr. Stephen Bennett's petition, pursuant to Government Code section 11340.6, to amend Property Tax Rule¹ 462.160, *Change in Ownership – Trusts*. In his petition, Mr. Bennett seeks to amend Rule 462.160 to "clarify" the change in ownership consequences when certain property interests terminate. He states that a recent California Supreme Court decision, *Steinhart v. County of Los Angeles (Steinhart)*,² raised two questions that should be clarified by Rule 462.160.

This matter is scheduled for the Board's consideration at the January 27, 2011, meeting³ on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition because, as explained in detail below, the questions raised in the petition have been answered by *Steinhart* and a recent California Court of Appeal decision, *Phelps v. Orange County Assessment Appeals Board No. 1 (Phelps)*.⁴ Furthermore, Mr. Bennett's proposed amendments to Rule 462.160 are contrary to *Phelps*.

This memorandum sets forth: (1) a general background of change in ownership law as it pertains to real property held in trusts; (2) a discussion of the petition and the requested amendments; and (3) staff's recommendation.

¹ All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

² (2010) 47 Cal.4th 1298.

³ Under Government Code section 11340.7, the Board has 30 days from receipt to take action on the petition. Petitioner states in his petition that he does not waive this deadline.

⁴ (2010) 187 Cal.App.4th 653.

I. General Background – Change in Ownership and Trusts

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a “change in ownership.” This section has been implemented by statutes enacted by the Legislature and Property Tax Rules promulgated by the Board of Equalization. As relevant here, such authorities regarding trusts include Revenue and Taxation Code section⁵ 60, section 61, subdivisions (g) and (h), section 62, subdivision (d), and Rule 462.160.

Section 60 defines a “change in ownership” as “. . . a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equivalent to the value of the fee interest.” This is often referred to as a three-part test. To meet the test, there must be: (1) a transfer of a present interest; (2) that includes beneficial use; (3) the value of which is substantially equivalent to the value of the fee. Section 61, subdivision (g), provides that a change in ownership occurs upon “[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.” Section 62, subdivision (d) excludes from change in ownership:

Any transfer by the trustor, or by the trustor’s spouse or registered domestic partner, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

Section 63 excludes interspousal transfers from change in ownership. Section 61, subdivision (h) states that a change in ownership occurs when “[a]ny interests in property” vest in persons other than a trustor or trustor’s spouse and the trust becomes irrevocable.

Rule 462.160 interprets change in ownership statutes as they apply to transfers involving trusts. It explains in subdivisions (a) and (c) that, generally, both the creation and termination of trusts will result in a change in ownership of trust real property. Rule 462.160, subdivisions (b) and (d) provide a number of exceptions to these general rules.

II. Discussion of Petition

The petition states that its genesis was the Supreme Court’s decision in *Steinhart*. In *Steinhart*, a trustor (Helfrick) created a revocable trust with herself as the sole beneficiary, and transferred a residence to the trust. Upon Helfrick’s death in 2001, the trust became irrevocable and under its terms, Helfrick’s sister, plaintiff Lorraine Steinhart (Steinhart), received a life estate in the residence with the remainder to Helfrick’s heirs. The Los Angeles County Assessor reassessed the residence since the transfer of the life estate to Steinhart caused a change in ownership.

Steinhart argued that the residence should not have been reassessed because no change in ownership occurred upon her receipt of the life estate in the residence based on the contention

⁵ Section references are to the Revenue and Taxation Code unless otherwise indicated.

that her life estate was not “substantially equivalent to the fee” as required by section 60.⁶ The Supreme Court disagreed, stating that Steinhart’s error was in focusing on the interest that she had received rather than on what interest was transferred by Helfrick. Because Helfrick, upon her death, had transferred the life estate and the remainder, she was left with no interest and thus had transferred the entire fee itself, not just an interest that was “substantially equivalent to the fee.”⁷ The Court did not find it necessary to determine whether the transfer of a life estate alone would result in a change in ownership, nor did it address whether there would be a subsequent change in ownership when Helfrick’s heirs obtained the remainder interest in the residence.⁸

The petition requests that the Board amend Rule 462.160 to provide three examples and several definitions (proposed by new subdivision (f)) that would purportedly answer the following two questions raised by the *Steinhart* decision.

1. Did the receipt by Lorraine Steinhart of her life estate in Helfrick’s residence on Helfrick’s death trigger a reassessable change in ownership?
2. Will Steinhart’s future death then trigger a reassessable change in ownership of the same residence?

We first note that *Steinhart* directly answers Question 1, and *Phelps*, which petitioner does not discuss, answers Question 2.

A. Question 1

Petitioner requests amendment of Rule 462.160 to clarify the application of section 61, subdivision (g) to his Question 1. However, no amendment to Rule 462.160 is necessary to answer petitioner’s Question 1 because section 61, subdivision (g) is unnecessary to answer it, and as explained in *Steinhart*, Rule 462.160 provides an answer. *Steinhart* held that sections 60, 61, subdivision (h), and 62, subdivision (d), and Rule 462.160 lead to the conclusion that a change in ownership of trust property occurs when a trust becomes irrevocable and the trustor transfers the entire equitable estate in the property. In fact, the Court goes through a detailed analysis of its conclusion beginning with section 2, subdivision (a), of Article XIII A of the Constitution, explaining how the relevant statutes are consistent with this constitutional provision, and finally explaining how the Board’s Rule 462.160 properly interprets those statutes. In this regard, the Court explained as follows:

The State Board of Equalization, through an implementing regulation, has also expressly addressed section 2, subdivision (a)’s [of Article XIII A of the California Constitution] application to transactions involving trusts. That regulation begins by stating a “[g]eneral [r]ule” that, for purposes of section 2, subdivision (a), “[t]he transfer by the trustor . . . of real property into a trust is a change in ownership . . . at the time of the transfer.” (Cal. Code Regs., tit. 18, § 462.160, subd. (a).) The regulation then specifies a list of “[e]xceptions” to the general rule—i.e., “transfers” involving trusts that “do not constitute changes in

⁶ *Steinhart*, *supra*, 47 Cal.4th at pp. 1323-1325.

⁷ *Ibid.*

⁸ *Ibid.*

ownership”—including, as here relevant: (1) “[t]he transfer of real property by the trustor to a trust in which the trustor-transferor is the sole present beneficiary of the trust” (*id.*, § 462.160, subd. (b)(1)(A)); and (2) “[t]he transfer of real property . . . by the trustor to a trust which is revocable by the trustor” (*id.*, § 462.160, subd. (b)(2)). [Fn. Omitted.] Regarding revocable trusts, the regulation further provides that “a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary or unless otherwise excluded from change in ownership.” (*Id.*, § 462.160, subd. (b)(2).)

We generally accord “great weight” to the statutes the Legislature has passed and the regulations the State Board of Equalization has promulgated to implement article XIII A. (*Amador, supra*, 22 Cal.3d at p. 246.) **Under both the express language of, and the underlying justification for, section 61, subdivision (h), section 62, subdivision (d), and the administrative regulation discussed above, it is clear that upon Helfrick’s death, a “change in ownership” under section 2, subdivision (a), occurred in this case.** Notably, Steinhart does not even argue otherwise, conceding in her brief that under “a literal application of” section 61, subdivision (h)’s language, “a change in ownership occurred” when Helfrick died, “the revocable trust became irrevocable,” and her (Steinhart’s) “life estate vested.”⁹ (Emphasis added.)

As noted by petitioner, in reaching this conclusion, the Court did not discuss section 61, subdivision (g). Such a discussion was unnecessary. The case was decided based on section 60, section 61, subdivision (h), section 62, subdivision (d), and Rule 462.160 because the event at issue was the transfer of a life estate to Steinhart as a result of Helfrick’s death and the trust becoming irrevocable. The Court’s omission of section 61, subdivision (g), in its analysis is consistent with the position that section 61, subdivision (g), becomes relevant only upon Steinhart’s death, when the remainder interests of Helfrick’s heirs become possessory. Rule 462.160 addresses petitioner’s Question 1 in subdivision (b)(1), which explains that a change in ownership of trust property occurs when a revocable trust becomes irrevocable, unless the trustor-transferor remains or becomes the sole present beneficiary or an applicable exclusion applies, which was not the case under the facts of *Steinhart*. Therefore, petitioner is incorrect in his implication that Rule 462.160 needs amendment to clarify the meaning of section 61, subdivision (g), to address his Question 1.

⁹ *Steinhart, supra*, 47 Cal.4th at pp. 1322-1323.

B. Question 2

To provide an answer to his Question 2, petitioner requests amendment of Rule 462.160 to add three examples and several definitions.¹⁰ In each of the examples, A creates a trust which becomes irrevocable upon A's death, at which time B receives a lifetime interest in income (a life estate) in real property. Upon B's death, C and D receive the remainder interest.¹¹ In such a situation, as explained above, *Steinhart* makes clear that a change in ownership occurs upon A's death. Petitioner asserts that Rule 462.160 needs to be amended to clarify whether a change in ownership occurs upon B's death. However, section 61, subdivision (g), Rule 462.160, and *Phelps* already make clear that a second change in ownership does in fact occur upon B's death. Petitioner's Examples 7 and 8 are contrary to these authorities.¹² In those examples, petitioner puts forth the analysis that since C's and D's remainder interests vested at the time of A's death, upon B's death, there is not a change in ownership. This is the same argument made by the plaintiff and rejected by the court in *Phelps*.

Relevant to this petition, in *Phelps*,¹³ a trustor died in 1947 at which time the trustor's three children and widow each received a lifetime income interest in the trust property. One of those children (Wilson) died in 2002, and pursuant to the terms of the trust, Wilson's life estate terminated and his children received the right to a one-third lifetime income interest in the property. The plaintiff argued that because all vested interests in the property were transferred in 1947, nothing was transferred when Wilson died in 2002, and that, therefore, no change in ownership of the property could occur in 2002.¹⁴ The Court disagreed stating that Proposition 13 tracks "real ownership of real property, which *Steinhart* determined followed the equitable estate."¹⁵ Thus, a change in ownership occurred in 2002 when Wilson no longer continued to own the property.¹⁶

Implicit in the court's reasoning is its analysis that Wilson possessed all three elements required to meet the three-part section 60 definition of change in ownership.¹⁷ In other words Wilson held a life estate which gave him (1) a present interest, (2) from which he derived beneficial use,

¹⁰ Because petitioner's definitions are intended to buttress his examples and the examples conflict with existing law, we do not specifically address the proposed definitions other than to state that their inclusion would also conflict with existing law.

¹¹ In his examples, petitioner includes additional facts, including that B has a general or special power of appointment that is either exercised or not exercised, as well as certain provisions of the trust regarding allocation of income and principal. None of the additional facts change the conclusion that a change in ownership occurs upon A's death and again upon B's death.

¹² While petitioner's proposed Example 5 is consistent in result with Board staff interpretations, this example would not improve the clarity of Rule 462.160 because its analysis is flawed.

¹³ *Phelps* came before the California Court of Appeal a second time after its first decision was vacated by the California Supreme Court and remanded for further consideration in light of *Steinhart*. (*Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448, judg. vacated and cause remanded for further consideration in light of *Steinhart* (2010) 47 Cal.4th 1298.) Upon reconsideration, the Court of Appeal reached the same conclusions and also explained how its decision was not inconsistent with *Steinhart*. *Phelps* again petitioned the California Supreme Court and his petition for review was denied. (*Phelps, supra*, 187 Cal.App.4th 653, cert. den. 2010 Cal.LEXIS 12265.)

¹⁴ *Phelps, supra*, 187 Cal.App.4th 653 at p. 666.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Phelps, supra*, 187 Cal.App.4th 653 at pp. 658-666.

and (3) the value of that use was substantially equivalent to the value of the fee. When Wilson died, his life estate terminated, a life estate interest passed to his children, and his children received all three elements previously held by Wilson, necessitating a change in ownership of their interest in the property.

The petition to amend Rule 462.160 fails to recognize that, upon the termination of a life estate in these examples, all three requirements necessary for a change in ownership are met. Petitioner's Examples 7 and 8 seem to concede that the second and third parts of the three-part test are met but ignore the present interest requirement of the first part of the test. The Examples state that no change in ownership occurs upon B's death because C's and D's remainder interests already vested upon A's death. Petitioner's analysis, however, fails to consider that a remainderman does not have present enjoyment of the property until the precedent estate has terminated. Until the remaindermen obtain the present enjoyment of the property, their interests are "future" interests that are to be protected from reassessment by section 60's present interest requirement.¹⁸ This is true even if the remainder interest becomes "vested" at an earlier time (i.e., upon grantor's death). Furthermore, this conclusion is supported by Rule 462.160, subdivision (d)(1), which states:

Prior Change in Ownership. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) when the trust was created, when it became irrevocable, or at some other time. However, a change in ownership also occurs when the remainder or reversionary interest *becomes possessory* if the holder of that interest is a person or entity other than the present beneficiary unless otherwise excluded from change in ownership. (Emphasis added.)

In petitioner's Examples 7 and 8, at B's death, a present interest in the property is transferred because B's interest terminates and C's and D's interests then become possessory. And, because C and D also have the beneficial use of the property, and their interest in the property is substantially equivalent to the value of the fee, all three parts of the section 60 definition of change in ownership are met at B's death. Therefore, contrary to petitioner's proposal, pursuant to *Phelps* and Rule 462.160, subdivision (d)(1), the property must be reassessed at that time.

The plaintiff in *Phelps* also argued, and petitioner also appears to be arguing, that *Steinhart* limited section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Phelps* rejected this argument and concluded that section 61, subdivision (g), supported its conclusion that a change in ownership occurred upon Wilson's death:

Plaintiff [Phelps, the trustee of the trust] notes that under section 61, subdivision (g), a change of ownership includes, "Any vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63." He observes "the section appears to state that every time a life estate ends and the remainder

¹⁸ Assem. Com. on Rev. & Tax., Report of the Task Force on Property Tax Administration (Jan. 22, 1979) at p. 39.

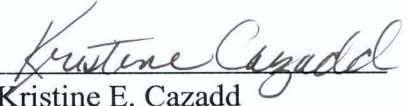
interest vests in another, this is an assessable change in ownership.” He contends *Steinhart* limits section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Steinhart* did not involve successive transfers or vesting of remainder interests under a trust, and the court did not discuss section 61, subdivision (g), in this context. [Citation omitted.] Cases are not authority for propositions not considered. (*Silverbrand v. County of Los Angeles* (2009) 46 Cal.4th 106, 127 [92 Cal. Rptr. 3d 595, 205 P.3d 1047].) **Section 61, subdivision (g), however, supports our conclusion the vesting of property rights in Wilson’s children upon termination of Wilson’s life interest effected a change of ownership.**¹⁹ (Emphasis added.)

Therefore, the petition should be denied because the proposed amendments directly contradict section 61, subdivision (g), and *Phelps*. Additionally, the appellate court’s analysis in *Phelps* is consistent with Rule 462.160, subdivision (d)(1) and inconsistent with the Rule amendments proposed by petitioner.

III. Staff’s Recommendation

Staff recommends that the Board deny the petition because the current version of Rule 462.160 conforms to the applicable statutes as applied in *Steinhart* and *Phelps*. In staff’s opinion, the requested regulatory change is contrary to these authorities.

If you need more information or have any questions, please contact Christine Bisauta, Acting Assistant Chief Counsel, at (916) 323-2549 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved: 
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¹⁹ *Phelps, supra*, 187 Cal.App.4th at p. 667.